

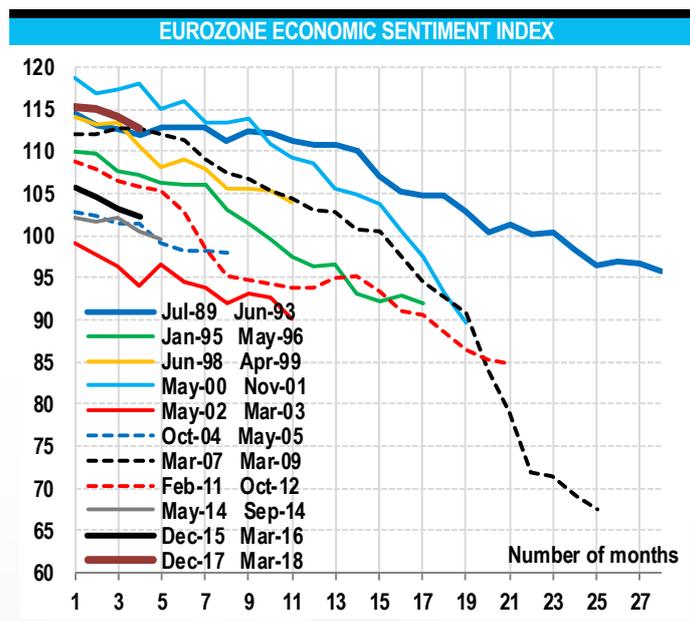
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Eurozone: softer sentiment, fundamentals still strong

■ Sentiment indicators have softened globally in recent months, including in the eurozone ■ The historical experience is varied although cyclical declines in eurozone sentiment have tended to last quite a number of months ■ Considering the current strong fundamentals, one would expect that weaker sentiment merely points to some moderation of growth

Sentiment indicators have softened globally as of late. Whilst this shouldn't come as a surprise considering the very high levels which had been reached, this development has created a certain unease given the close correlation between these indicators and economic activity. For the eurozone, the European Commission's Economic Sentiment Index (ESI), a composite indicator covering several sectors (industry, services, consumer, retail trade and construction), is one indicator amongst several which has seen a decline. It reached a peak last December at 115.3 (the record of 118.6 was set in May 2000) and has been declining since. The chart tracks the 10 cyclical declines which have been witnessed previously since the end of the 80s. One notices that they tend to last for several months (7 out of 10 lasted 11 months or longer) although there are exceptions. The variety of experiences means it is difficult to form an a priori of what could happen this time around. After all, the historical declines need to be seen in their context, just like we need to look at the drivers of final demand at the current juncture. In this respect, reasons to remain confident are plentiful: low real interest rates, a cautious ECB, increasing employment, the prospect of some pick-up in wage growth, rising capacity utilisation, growth in corporate profits, a still favourable global environment. In addition, fiscal stimulus in Germany and the US should provide support to growth. This would mean that the softer survey data point towards somewhat slower quarterly growth, nothing more. This also seems to be the assumption of the IMF which in its latest World Economic Outlook has eurozone GDP growing at 2.0% year over year in Q4 2019, which is still well above potential. Based on a regression between GDP growth and the ESI, this would imply an ESI of about 101 by the end of next year. Though caution is warranted (the statistical relationship is close but not perfect), this would mean a slow, moderate weakening of sentiment. One should remain vigilant however: a prolonged decline could increase uncertainty and become self-reinforcing.



Sources: European Commission, BNP Paribas.

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